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Politics and Markets

As the U.S. presidential election draws closer, many have started to worry about how the outcome may affect the markets. But are these election fears overstated?

Brad McMillan, CFA®, CAIA, MAI, managing principal and chief investment officer at Commonwealth Financial Network®, the firm we partner with to serve you, has written a piece that focuses on the power of politics when it comes to the economy and the markets. He also discusses whether we're in a "normal" political cycle and what we may expect going forward.

As always, our goal is to keep you informed and help you stay on track toward your long-term financial goals. If you have questions about anything in the attached article, please don't hesitate to contact our office.

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Does the Presidential Election Spell Risk for the Markets?

Presented by Christopher R. Collins, CFP®, AIF® and Scott McCaffery, CFP®, AIF®

As the U.S. presidential election draws closer, there are growing questions (from both sides) on whether the outcome will negatively affect the markets. Of course, this is not unusual. As you may remember from the last election cycle, many predicted doom if Trump were to win. In the election before that, we saw similar worries concerning Obama. In both cases, despite the fears, the markets ended up doing quite well. Given this, what risks—if any—does the upcoming election pose for the markets? Let's take a closer look.

Are Election Fears Overstated?

Politics has less of an effect on the economy and, therefore, the markets than we think. Since 1900, according to Bespoke Research, the average gain for the Dow Jones Industrial Average has been 4.8 percent per year, reflecting the economy as a whole. Decade after decade, markets have moved ahead as the economy grew, regardless of the party in power.

When we do see a political influence, it is not what might be expected. The average Republican administration over that time period saw gains of 3.5 percent per year, while the Democrats saw gains of almost twice as much, at 6.7 percent per year. Recent decades have seen the same pattern, with annual gains under Clinton and Obama exceeding those of both Bushes and Trump (so far).

Put in that context, fears about the election look to be overstated. Trump is a known quantity. So, if he is reelected, the effect should be minor. If the Democrat is elected, history shows that there is a good chance that, over time, the markets will do at least as well.

Will Things Be Different This Time?

They could be. Biden plans to raise taxes significantly if elected, which would hit corporate profit margins. If margins decline, so do earnings—and so does the stock market. Higher taxes on the rich would also presumably hit their spending, which would be a drag on growth. These are real concerns.

They are not, however, any different from the concerns that normally accompany a Democratic administration. And, as noted, the Democrats have historically generated higher market returns. Why? Higher taxes are accompanied by higher spending, which also acts to stimulate the economy and the market. We have seen the same effect in recent months, when increased spending by the Trump administration has kept the economy afloat, and a Biden administration would likely expand that support.

Have We Been Here Before?

Indeed, this is a normal political cycle. The Republicans take office and cut taxes and spending, and the Democrats then take office and do the reverse. We have seen this pattern many times before, most recently with Obama to Trump.

It is also normal, however, for both sides to make the change look as apocalyptic as possible in hopes of motivating their donors and voters—and that is exactly what we are seeing at the moment. The headlines that point out these likely changes are designed to get maximum attention by maximizing the potential consequences. Hence, the questions and concerns.

The reality, however, is likely to be much less scary. The next president will likely have to deal with a divided government, limiting the administration's ability to pass any significant changes. Even if the Democrats were to take the Senate, a Biden administration would not have a filibuster-proof majority and likely could not rely on all the Democrats to vote for anything radical. The American political system is designed to be hard to change. Nothing in this election will change that, no matter who wins.

The Real Risks

As investors trying to analyze the election, we should take note that there are certainly risks, but also opportunities. No matter who wins, there will be policy changes, but almost certainly nothing too radical. The real risks will come from reactions to the headlines, rather than to the underlying data. In other words, we should treat this like any other event and act on what actually happens, rather than on whatever disaster the headlines are peddling today.

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